Common Payroll Pitfalls

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Who is an Employee

• An employer-employee relationship generally exists if the person contracting for services has the right to control not only the result of the services, but also the means by which that result is accomplished. In other words, an employer-employee relationship generally exists if the person providing the services “is subject to the will and control of the employer not only as to what shall be done but how it shall be done.” (Treas. Reg. sec. 31.3401(c)-(1)(b).)
“Independent Contractors”

• Some employers wish to categorize individuals as “independent contractors.”
• This is often a method of lowering costs for the employer.
  – Payroll taxes
  – Workers’ compensation
  – Employee benefits
  – Administration
• Regulatory agencies frequently find that individuals have been improperly classified.
  – 1984 IRS survey of 3,331 employers found that 15 percent of employers misclassified employees.
  – Of 11,380 audits of employers conducted by the IRS between 1988 - 1994 identified 483,000 workers who were misclassified.

(IRS Report JCX-26-07)
Growth in Misclassification?

- DOL initiative under the Vice President’s “Middle Class Task Force” seeks to combat misclassification of employees.
Why the Crackdown?

Misclassified employees are often denied access to critical benefits and protections - such as family and medical leave, overtime, minimum wage and unemployment insurance - to which they are entitled. Employee misclassification also generates substantial losses to the Treasury and the Social Security and Medicare funds, as well as to state unemployment insurance and workers compensation funds.
IRS Factor 20 Test

- 20 factors identified by the IRS in determining whether an employer-employee relationship exists.
- Degree of significance of each factor varies depending upon the nature of the job and the specific circumstances.
- Any combination of factors may indicate an employment relationship, there is no “simple” threshold.
- The IRS also identifies three categories in addition to the 20 factors.
  - Behavioral control
  - Financial control
  - Relationship of the parties

(IRS Report JCX-26-07)
DOL Economic Reality Test

1. The extent to which the services rendered are an integral part of the principal's business.
2. The permanency of the relationship.
3. The amount of the alleged contractor's investment in facilities and equipment.
4. The nature and degree of control by the principal.
5. The alleged contractor's opportunities for profit and loss.
6. The amount of initiative, judgment, or foresight in open market competition with others required for the success of the claimed independent contractor.
7. The degree of independent business organization and operation.
Exempt Employees

• By default employees are non exempt. Which means:
  – They are entitled to minimum wage.
  – They are entitled to overtime pay.

• Some employees may meet the requirements for an exemption from minimum wage and overtime requirements under several statutory exemptions, which include:
  – Administrative
  – Executive
  – Professional
  – Outside sales
  – Computer
  – Highly Compensated
Salary Basis

- Most exemptions require an employee to be paid on a “Salary Basis.”
- Salary must be at least $455 per week for any week worked.
- Cannot be reduced because of variations in quality or quantity of work regardless of days or hours worked.
- May make deductions for sick days, if lost income is replaced from a bona fide sick or PTO plan.
- May make deductions for “personal” days.
- May make deductions for unpaid suspensions or safety violations.
- May pay less than a full week in first or last week on the job.
To qualify for the administrative employee exemption, all of the following tests must be met:

• The employee must be compensated on a salary or fee basis (as defined in the regulations) at a rate not less than $455 per week;

• The employee’s primary duty must be the performance of office or non-manual work directly related to the management or general business operations of the employer or the employer’s customers; and

• The employee’s primary duty includes the exercise of discretion and independent judgment with respect to matters of significance.

(DOL Fact Sheet #17C)
Executive

To qualify for the executive employee exemption, all of the following tests must be met:

• The employee must be compensated on a salary basis (as defined in the regulations) at a rate not less than $455 per week;

• The employee’s primary duty must be managing the enterprise, or managing a customarily recognized department or subdivision of the enterprise;

• The employee must customarily and regularly direct the work of at least two or more other full-time employees or their equivalent; and

• The employee must have the authority to hire or fire other employees, or the employee’s suggestions and recommendations as to the hiring, firing, advancement, promotion or any other change of status of other employees must be given particular weight.

(DOL Fact Sheet #17B)
Learned Professional

To qualify for the learned professional employee exemption, all of the following tests must be met:

• The employee must be compensated on a salary or fee basis (as defined in the regulations) at a rate not less than $455 per week;

• The employee’s primary duty must be the performance of work requiring advanced knowledge, defined as work which is predominantly intellectual in character and which includes work requiring the consistent exercise of discretion and judgment;

• The advanced knowledge must be in a field of science or learning; and

• The advanced knowledge must be customarily acquired by a prolonged course of specialized intellectual instruction.

(DOL Fact Sheet #17D)
Creative Professional

To qualify for the creative professional employee exemption, all of the following tests must be met:

• The employee must be compensated on a salary or fee basis (as defined in the regulations) at a rate not less than $455 per week;

• The employee’s primary duty must be the performance of work requiring invention, imagination, originality or talent in a recognized field of artistic or creative endeavor.

(DOL Fact Sheet #17D)
Outside Sales

To qualify for the outside sales employee exemption, all of the following tests must be met:

• The employee’s primary duty must be making sales (as defined in the FLSA), or obtaining orders or contracts for services or for the use of facilities for which a consideration will be paid by the client or customer; and

• The employee must be customarily and regularly engaged away from the employer’s place or places of business.

(DOL Fact Sheet #17D)
To qualify for the computer employee exemption, the following tests must be met:

- The employee must be compensated either on a salary or fee basis at a rate not less than $455 per week or, if compensated on an hourly basis, at a rate not less than $27.63 an hour;
- The employee must be employed as a computer systems analyst, computer programmer, software engineer or other similarly skilled worker in the computer field performing the duties described below;
- The employee’s primary duty must consist of:
  - The application of systems analysis techniques and procedures, including consulting with users, to determine hardware, software or system functional specifications;
  - The design, development, documentation, analysis, creation, testing or modification of computer systems or programs, including prototypes, based on and related to user or system design specifications;
  - The design, documentation, testing, creation or modification of computer programs related to machine operating systems; or
  - A combination of the aforementioned duties, the performance of which requires the same level of skills.

(DOL Fact Sheet #17E)
Highly Compensated

The regulations contain a special rule for “highly-compensated” workers who are paid total annual compensation of $100,000 or more. A highly compensated employee is deemed exempt under Section 13(a)(1) if:

- The employee earns total annual compensation of $100,000 or more, which includes at least $455 per week paid on a salary basis;
- The employee’s primary duty includes performing office or non-manual work; and
- The employee customarily and regularly performs at least one of the exempt duties or responsibilities of an exempt executive, administrative or professional employee.

(DOL Fact Sheet #17H)
By statutory definition the term "employ" includes "to suffer or permit to work." The workweek ordinarily includes all time during which an employee is necessarily required to be on the employer's premises, on duty or at a prescribed work place. "Workday", in general, means the period between the time on any particular day when such employee commences his/her "principal activity" and the time on that day at which he/she ceases such principal activity or activities. The workday may therefore be longer than the employee's scheduled shift, hours, tour of duty, or production line time.

(DOL Fact Sheet #22)
Common Problems Calculating Hours Worked

• Waiting Time
  – “Waiting to be Engaged”
  – “Engaged to Wait”

• On-Call Time

• Rest and Meal Periods
  – Duration
  – “Completely Relieved from Duty”

• Sleeping Time

• Lectures, Meetings and Training

• Travel Time
  – Home to Work
  – Home to Work on a Special One Day Assignment in Another City
  – Travel That is All in A Day’s Work
  – Travel Away from Home Community
Overtime Pay

• The federal overtime provisions are contained in the Fair Labor Standards Act (FLSA). Unless exempt, employees covered by the Act must receive overtime pay for hours worked over 40 in a workweek at a rate not less than time and one-half their regular rates of pay. There is no limit in the Act on the number of hours employees aged 16 and older may work in any workweek. The Act does not require overtime pay for work on Saturdays, Sundays, holidays, or regular days of rest, unless overtime is worked on such days.

• The Act applies on a workweek basis. An employee's workweek is a fixed and regularly recurring period of 168 hours – seven consecutive 24-hour periods. It need not coincide with the calendar week, but may begin on any day and at any hour of the day. Different workweeks may be established for different employees or groups of employees. Averaging of hours over two or more weeks is not permitted. Normally, overtime pay earned in a particular workweek must be paid on the regular pay day for the pay period in which the wages were earned.

• Some states (such as California) have more stringent overtime requirements.
Regular Rate of Pay

- The regular rate includes all remuneration for employment except certain payments excluded by the Act itself. Payments which are not part of the regular rate include pay for expenses incurred on the employer's behalf, premium payments for overtime work or the true premiums paid for work on Saturdays, Sundays, and holidays, discretionary bonuses, gifts and payments in the nature of gifts on special occasions, and payments for occasional periods when no work is performed due to vacation, holidays, or illness.

- Earnings may be determined on a piece-rate, salary, commission, or some other basis, but in all such cases the overtime pay due must be computed on the basis of the average hourly rate derived from such earnings. This is calculated by dividing the total pay for employment (except for the statutory exclusions noted above) in any workweek by the total number of hours actually worked.

(DOL Fact Sheet #23)
Recordkeeping

1. Employee's full name and social security number.
2. Address, including zip code.
3. Birth date, if younger than 19.
4. Sex and occupation.
5. Time and day of week when employee's workweek begins.
6. Hours worked each day.
7. Total hours worked each workweek.
8. Basis on which employee's wages are paid (e.g., "$9 per hour", "$440 a week", "piecework")
9. Regular hourly pay rate.
10. Total daily or weekly straight-time earnings.
11. Total overtime earnings for the workweek.
12. All additions to or deductions from the employee's wages.
13. Total wages paid each pay period.
14. Date of payment and the pay period covered by the payment.

(DOL Fact Sheet #21)
Pay Frequency

- Largely up to the employer under the FLSA so long as it is consistent.
- Almost every state stipulates specific frequencies (e.g. weekly, bi-weekly, etc).
- May depend upon the type of job (e.g. white vs. blue collar, etc.)
Deductions from Pay

• Section 125 Salary Reduction Agreements
  – Health Insurance & Other Benefits

• Other Deductions
  – Employees must be made aware of the types and amounts of deductions.
  – May not reduce wages below the minimum wage.
  – May not reduce overtime compensation.
  – Uniforms
  – Cash Shortages
  – Damage to Property
  – Tools and other Equipment
Questions?

Thank you.